『学習院大学　経済論集』第48巻　第1号（2011年4月）

A Brief History of Accounting for Goodwill in Japan and France: War, Tax and Accounting Practice

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ABSTRACT

Following the work by Ding et al. (2008) on accounting for goodwill in Western countries, this paper seeks to provide more details about goodwill history in Japan and France.

Unlike in Anglo-Saxon countries, accounting for goodwill in France has been mainly tax-dominated during the 20th century. Only in the 1980s did European directives challenge a long tradition of permanent retention of goodwill. Recently, the growing influence of international accounting standards comforted the French tax tradition on permanent retention against newly introduced amortization.

Ding et al. (2008) concluded that the French goodwill history was an exception compared with the three other countries of their study (United States, Great Britain and Germany) where tax seemed to have little influence on goodwill. In this paper, we argue the opposite: goodwill accounting in Japan was also influenced by tax during the 20th century, especially in the interwar period.

In the 1930s, the Japanese tax administration recommended that goodwill should be capitalized and amortized, which was uncommon in the interwar period. Despite many accounting academics disagreed with goodwill capitalization at that time, business practices complied with tax requirements. After the war, the treatment of goodwill in financial accounting grew away from tax, but tax practices remained influent indirectly through the *pooling-of-interests* method of accounting for business combinations.

Key Words: *Goodwill, Accounting History*

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1. Introduction

Since more than 130 years, goodwill has been the subject of much literature in accounting. Despite all the main theories of goodwill had already been exposed as early as the beginning of the 20th century, there were many turnarounds in the debate until today.

One of the earliest authorities concerning goodwill was Dicksee, whose position remained influential all over the 20th century. Considering that goodwill was a permanent asset just like land, he rejected the gradual amortization method. On the contrary, he recommended immediate write-off to capital, arguing that goodwill was "an asset which is undesirable to retain as such". If goodwill was written on the books, changes in the asset's value would give rise to an artificial exaggeration of the natural fluctuations of reported income. To avoid such technical embarrassment, Dicksee recommended that goodwill should be charged to capital immediately (Dicksee, 1897). Since Dicksee, many theories have been advocated, with unequal success over time and countries: goodwill could be permanently retained on the balance sheet, or amortized over long periods, or immediately written off against reserves…

Prior studies about goodwill history have shown the contingency of accounting methods to economic circumstances (Hughes, 1972), conflicting interests (Nobes, 1992, Bryer, 1995), or dominant stakeholders (Ding et al., 2008).

Our study investigates the historical influence of tax on accounting for goodwill in two countries: Japan and France. For the French case, Ding et al. (2008) have already provided an outline of changes, but we intend to give more detail on the tax influence. For the Japanese case, this paper is a first about goodwill history, since it includes the pre-war period.

After introducing prior historical research about goodwill, we present the development of accounting for goodwill in France and in Japan.

2. Prior research on goodwill history

2.1. Single country studies

The History of goodwill and business combinations

Hughes (1972, 1982) investigated extensively American and early British accounting literature from the 1880's to the 1970's. Considering that "goodwill is a product of business", he analyzed the apparition and intensity of theories within their business environment.

A history of the mergers movements in the US is provided by Bump (1970), who showed the influence of institutional factors such as antitrust laws and tax pressures. Some historians have also made analyses about other countries, particularly the United Kingdom (Holgate, 1990, Nobes, 1992, Bryer, 1995), an important stream of which have based their interpretation of accounting change on the conflict between social actors' interests.

Social and critical viewpoints on goodwill history

Nobes (1992) identified several parties involved in the political process of standard setting in the UK, and concluded that different pressures resulted in a "cyclical standard setting" of goodwill in the 1980's:

on the one hand, "managers opposed standardization and income reduction, whereas senior policy makers, government, press and international influences proposed it".

Bryer (1995) also gave his interpretation of the same phenomena on the basis of a Marxist analysis. Accounting information is "necessary to allow the capital markets to observe the generation and realization of profit and the rate of return on capital." According to him, the British exception of SSAP 22 encouraging write-offs of goodwill "was in the collective interest of investors because it helped to hide from public view the fact that dividends were being paid from capital."

Goodwill and underlying theories

Garcia (2006) investigated the relationship between accounting treatments of goodwill and underlying theories in the American accounting literature of the 20th century. Two basic assumptions were used to classify the different treatments of goodwill.

The first one is whether accounting should be primarily focused on the representation of annual income or the representation of net worth. From these basic views derive the two usual acceptations of goodwill: a composite cost or an excess earning power. The second assumption is whether goodwill meets or not the definition of an asset[2]. A simplified classification is reproduced in the following chart.

Goodwill and underlying accounting assumptions

<table>
<tr><td colspan="2" rowspan="2">Assumptions</td><td colspan="2">To what information should accounting give priority?</td></tr>
<tr><td>Flows (~P/L)</td><td>Stocks (~B/S)</td></tr>
<tr><td rowspan="2">Does goodwill meet the definition of an asset?</td><td>Asset
(less conservative)</td><td>Valuation at cost
Amortization over useful life</td><td>Market value
No amortization</td></tr>
<tr><td>Not Asset
(more conservative)</td><td>Valuation at cost
Immediate write-off against reserves</td><td>Liquidation value
Rapid expensing</td></tr>
</table>

(source: Garcia, 2006; P/L: income statement, B/S: balance sheet)

The findings in Garcia (2006) reveal that at first (1880-1929), accounting for goodwill in the U. S. was net worth-oriented, with permanent retention as the preferred method. The Great Depression, however, put an end to the balance sheet approach. Then, as the historical cost paradigm gradually took the lead in accounting, there was increased support for goodwill's amortization. After World War II, prosperous economic circumstances perpetuated the stability of the historical cost valuation and saw a constant promotion of amortization views. Yet, serious doubts about goodwill's finite useful life or earning capacity were raised. Immediate write-off then rose as an alternative to amortization and was broadly used in practice. Forbidden in the 1950s, it was soon replaced with the pooling-of-interests method that

2） In other words, this assumption is derived from the question: what is an asset? To some extent, it shows the degree of conservatism in asset recognition.

also allowed not capitalizing goodwill.

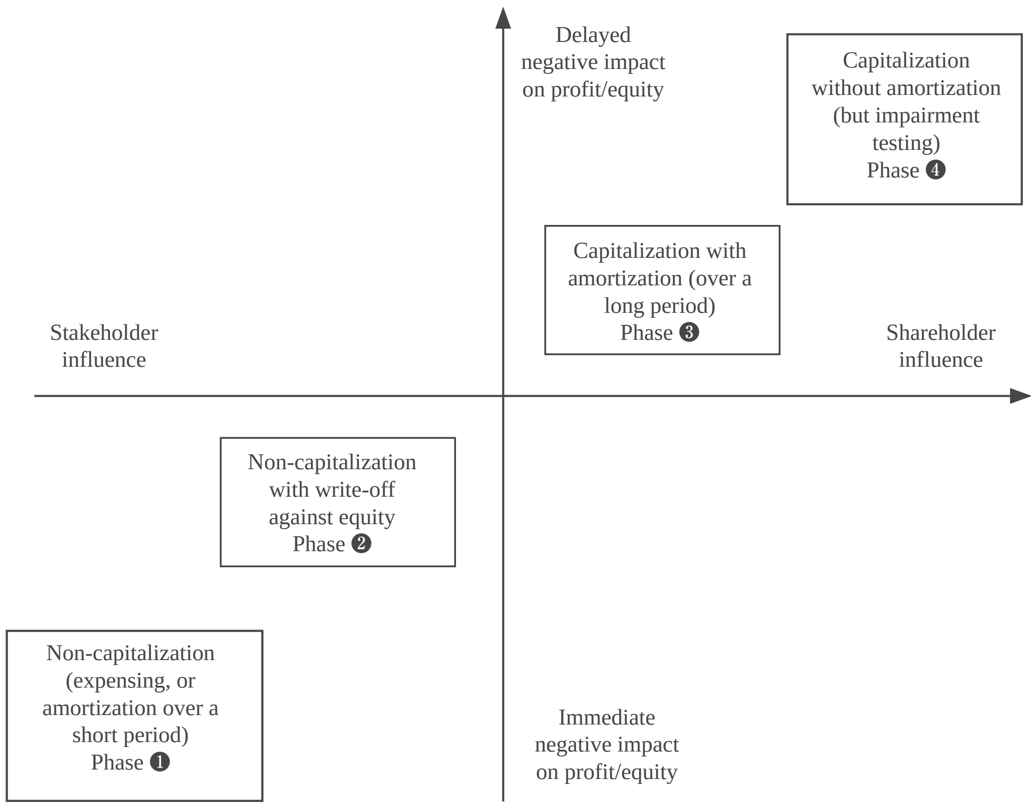
In the 1980s and 1990s, the significant growth of financial markets resulted in increasingly targeting information at short term investors with more emphasis on the concept of present value. This change led to the final adoption of permanent retention with impairment tests in SFAS No. 141 and 142 (2001).

2.2. Comparative studies

Goodwill and dominant interests

Ding et al. (2008) proposed a comparative history of accounting for goodwill in four countries: the US, the UK, Germany and France. Based on economic consequences of alternative accounting treatments, they argue that the competing influence of four social groups involved in accounting issues (investors, managers, creditors and the tax administration) determines the dominant treatment of goodwill.

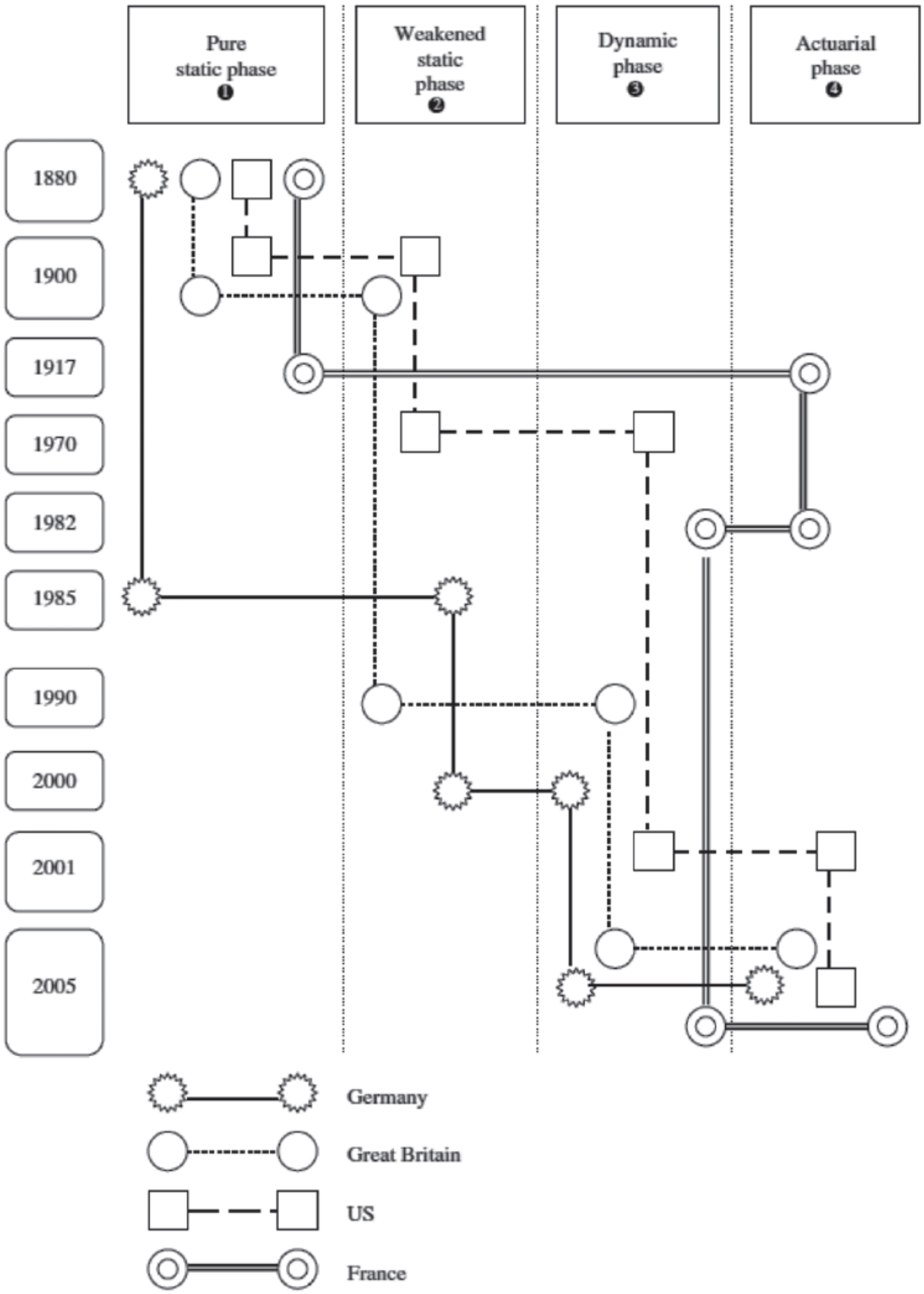
Economic consequences of alternative accounting treatments of goodwill



(source: Ding et al., 2008)

Based on this framework, they studied changes in the dominant method of accounting for goodwill in Germany, France, the U. K. and the U. S. The following chart presents a summary of their findings.

Evolution of dominant goodwill theories in Germany, Great Britain, the U. S. and France



(source: Ding et al., 2008)

The study by Ding et al. (2008) concludes that the history of accounting for goodwill in France was an exception with regard to the three other countries. As a matter of fact, France directly switched from the “static” to the “actuarial” phase in 1917 after the refusal by the tax administration of expensing goodwill.

Goodwill in Japan and France

Garcia (2010) investigated the history of goodwill in Japan and France, distinguishing the same competing theories as Garcia (2006) and Ding et al. (2008). But unlike in Ding et al. (2008), the “pooling-of-interests” is considered an alternate treatment of the “weakened static” school (non capitalization of goodwill with write-off against equity).

In the U. S., Hughes (1982) noted that the pooling-of-interests, despite it appeared in the 1920s, became an important issue when write-offs were forbidden (ARB No. 43, 1953). Originally created to account for business combinations between companies of a similar size, its basic idea was that neither corporation had purchased the other, but two formerly independent entities were acting as one. Consequently, assets of both companies were to be “pooled” together and retained in the new entity's balance sheet for their original book value. No purchased goodwill was to be recorded. Moreover, a pooling-of-interests combination was free of tax.

In order to better assess the influence of tax on goodwill accounting in Japan and France, it is preferable to include the “pooling-of-interests” in the scope of this study. Garcia (2010) considered that this method was a means of non-recognition of goodwill, just as immediate expensing or writing off against equity.

According to Garcia (2010), evidence in Japanese literature suggests that tax and accounting practice were closely linked at the beginning of the 20th century. Moreover, goodwill amortization was deductible for tax purpose in the pre-war period, which is very much in advance compared with other countries.

2.3. Research design

Ding et al. (2008) suggested the dominant influence of tax on accounting for goodwill in France until the 1980s, but they argue that such case is an exception. Our study investigates, based on the findings of Garcia (2010), how the Japanese path was also tax-dominated at the same period.

We also discuss the relationship between state interventionism, tax and goodwill. As a matter of fact, income tax has been introduced in the U. S., France and Japan in order to finance World War I in 1917, and was afterwards used as a means of influencing business decisions (for example, by setting reduced tax on physical investments). In this regard, tax regulation is an expression of state interventionism, and its influence on goodwill points out that the administration is also a powerful stakeholder in accounting practices.

Last, in the Japanese case, prior research (Fujita and Garcia, 2005, Suzuki, 2007a and 2007b, Saito, 2010) showed the rupture between pre-war and post-war accounting due to changes imposed by the American GHQ. For that reason, we separate the two periods in this study.

3. Accounting for goodwill in France

The French *Code Général des Impôts* (Tax Code) is famous for its 1965 articles, a number much larger than the 365 different types of French cheese. Such amount of legislation is the fruit of a long tradition of centralized power and economic interventionism (Neurisse, 1996).

The roots of the current income tax system can be found in 1917, when the French government needed funds to finance World War I. Since then, the development of accounting has paralleled tax reforms with so much similitude that accountants called it the “rapt of accounting by taxation”. Accounting for goodwill is not an exception, as we will see in the next paragraphs.

3.1. Tax-deductibility of goodwill amortization

Creation of income tax in 1914-1917

In France, the promulgation of the “Impôt général sur les revenus[3] ” (General Income Tax) in 1914 coincides with the beginning of World War I, but the implementation decree was passed only in 1916[4]. In 1917, the new tax system was completed with the creation of several types of tax based on the nature of income[5] : salary, industrial and commercial profit, property income, financial investment income, agricultural income and non-commercial income. For businesses, the main tax system was industrial and commercial profit.

War, State budget and tax

The project of a new income tax system started in 1894, long before World War I, but the budgetary deficits incurred by military expenses were a major incentive for the parliament to accept the reforms in 1914, 1916 and 1917 (Neurisse, 1996).

In the interwar period, tax rates increased from 1.5% in 1917 to 21% in 1939 due to public spending on military expense and social welfare (Wolff, 1970). The next major reforms in income tax were passed during and after World War II, when the French government faced the necessity to rebuild infrastructures destroyed during the conflicts. In 1948, the tax system for legal entities was created and the tax rate increased up to 36% (Neurisse, 1996).

Since the 1950s, taxation has been used as a means of influencing economic actors. Tax reductions were granted for certain transactions, or on the contrary supplementary deductions were required for others (Neurisse, 1996). For example, investing in certain activities or in non polluting equipment can entitle to some tax reductions.

As Wolff (1970) and Neurisse (1996) described, major changes in the 20th century corresponded to important social crises like war. Similarly, tax rate increases corresponded to interventionist policies.

3） Act of July 15, 1914.

4） Decree of January 15, 1916.

5） Act of July 31, 1917.

The goodwill issue

When the 1917 tax system was implemented, it took several years to build up jurisprudence. As far as goodwill[6] is concerned, two important debates arose in the 1920s.

- Are gains in value concerning goodwill part of taxable income?
- Should goodwill be amortized, and would amortization be deductible?

Net income and capital gains on goodwill

In the 1917 Act, article 4 decrees that businesses are "taxed on the basis of net income, after deduction of all expenses including the rent of all buildings used for operations and including also depreciation expenses in accordance with practices generally admitted in each kind of industry and commerce."

Unfortunately, the text did not define the concept of net income. In 1922, the tax administration considered that gains generated by the sale of all kinds of assets including goodwill were taxable (Brière, 1934). In this regard, the tax administration adopted the balance sheet approach to define net income theoretically.

Yet, the income statement at that time "never included gains or losses from the sale of assets, or of the business itself." The differences between accounting practice and the new tax rule resulted in several trials lost by the tax administration (Brière, 1934).

In 1925, a cabinet decision (September 15, 1925) officially exonerated the gains on intangible assets, equipment and buildings used in the business. The reason for such turnaround was that the parliament considered that acquired goodwill was not taxable revenue but rather capital gain (Brière, 1934). Theoretically, this approach reflects a narrower view of net income, where profit is the difference between operating revenues and expenses.

In fact, the budgetary consequences of this exoneration were so important that the administration reduced its scope in 1927: it was then limited to the gains incurred by business transfers (Brière, 1934). Delattre (1929, in Brière, 1934) explained that the tax administration was much attached to the asset and liability view so that they wanted to return to this approach. The consequence was that a new category of taxation appeared for capital gains.

Amortization of goodwill

According to Brière (1934), the deductibility issue for the amortization of goodwill was closely linked with the taxation of capital gains.

Since 1925, when goodwill was recognized on the books, it was exonerated of tax, and in 1926, the tax administration decreed that "in return, the depreciation of such element cannot be deduced from tax base." As a result, "amortization cannot be taken into account for the calculation of tax in the category industrial and commercial profit".

The debate about amortization ended up in 1928 with a ministerial directive[7] stipulating that amortization expenses for goodwill were not deductible; but that a provision for depreciation would be

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6) Non consolidation goodwill, "fonds commercial" in French.

7) Ministerial directive of January 31, 1928, article 29.

deductible when the company could prove that the loss was effective and definitive. It was confirmed later by several decisions of the Council of State[8)] (Turot, 1996).

Consequently, the administration recommended retaining goodwill permanently on the balance sheet and forbade amortization. Interestingly, this method can be seen as a precursor for the current position of international accounting standards.

As tax and accounting were very closely linked, goodwill was not amortized in practice in French companies. Only in the 1980s did European harmonization bring several reforms into French standards.

3.2. International harmonization and goodwill accounting in France

All over the 20th century, the main position of the tax administration regarding goodwill did not change. In the 1980s, though, two elements started counterbalancing the tax influence. First, some large French companies disclosed consolidated accounts based on American practices, according to which goodwill was amortized. Secondly, the European harmonization process brought a new *plan comptable* (list of accounts) in 1982, a new standard for group accounts in 1999, and eventually IFRS[9)] adoption for listed entities in 2005.

The Plan Comptable Général 1982

In 1982, a new list of accounts *(Plan Comptable Général, PCG*) was published as the French adaptation of the 4th European directive on accounting (1978). Unlike the French system, which was completely tax-dominated, the directive was a compromise between accounting practices in different countries: Germany, Italy, France, Great Britain...

Consequently, the PCG 1982 introduced a new account: “No. 2807: Amortization of goodwill”, but the text did not mention explicitly the obligation to amortize goodwill. As accounting practice was much influenced by tax, most companies did not amortize goodwill in individual accounts.

In 2004, a much later text confirmed non amortization of goodwill as the standard method in individual accounts. “Opinion on Assets”, a standard by the CNC[10)] , decreed that some intangible assets must be amortized like patents, development costs, software...others must only be written down when impaired like brands, goodwill, rights to the lease...

In individual accounts, non amortization of goodwill was also supported by economic circumstances (Council of State, 1999): “French companies have limited own funds and large intangible assets; making these intangibles disappear by the means of amortization would have a negative impact on the structure of their balance sheet.” In other words, French companies had too much debt and writing down intangibles would dangerously worsen their gearing ratios.

To sum up, the Council of State, the highest administrative authority in France, was against goodwill amortization for budgetary reasons and also for financial disclosure (Turot, 1996).

Budgetary reasons subtended all decisions about goodwill in 1925, 1926, 1928, as noted by Brière

8） Highest administrative court.

9） International Financial Reporting Standards.

10） Conseil National de la Comptabilité, renamed in 2009 Autorité des Normes Comptables, the French standard-setting body.

(1934). In 1996, the same assessment was made by Turot: the weight of intangible assets on the balance sheet of large French companies was so heavy that amortization would cost 18 billion francs[11] to the State. Moreover, permanent retention of goodwill was supported not only by the tax administration, but also by businesses themselves, since this method allowed a more favourable presentation of the balance sheet.

Consolidation Goodwill

In France, indirect financing and private direct investment have traditionally been the main financing sources for businesses. Yet, a few large companies gradually benefitted from foreign investments since the 1970s.

In the 1970s, large companies started to publish consolidated accounts inspired by American practices (Bensadon, 2009). As the French Law did not require disclosing consolidated accounts until 1985, and as the tax administration was concerned only with tax declarations, companies were free to choose the practices they preferred.

The 7th European directive (1983) adapted in French law in 1985 resulted in a new compromise among the practices of several countries. Compared with the 4th directive (1978), the Anglo-Saxon influence was much greater, reflecting the attraction of European companies by the American model of finance.

As in the American rules at that time, many French multinational companies started to amortize goodwill. A survey made by French audit firms (CCAS et al., 1996) on consolidated accounts of listed companies showed that 31 groups out of 62 used to amortize goodwill and only 22 groups wrote on provisions for depreciation[12]. As far as amortization periods are concerned, the same study (CCAS et al., 1996) reveals that the 31 groups amortizing goodwill chose heterogeneous periods: maximum 5 years (23%), 5 to 20 years (32%), 20 to 25 years (9%) and 25 to 40 years (23%)[13] .

This study reveals two important points about French accounting in the 1990s. First, group accounts were insufficiently regulated, resulting in a wide scope of practices. For example, the French version of the pooling-of-interests was introduced as the "méthode dérogatoire" in 1999, but it was already used in practice much earlier. Hopefully, in 1999, this lack of homogeneity was partly reduced by the Regulation 99-02 about consolidated accounts.

The second point is that French companies adopted, for the purpose of financial disclosure, a double standard system much before adopting international standards. At the beginning, using a different basis for consolidated accounts was not a big problem, since many options were offered to companies. Yet, the range of possible options offered in consolidated accounting standards was reduced in 1999 in order to improve comparability. Some of the remaining options were defined as "preferential methods", usually the ones closer to international standards.

As far as goodwill is concerned, the Regulation 99-02 decreed that it should be amortized over its useful life, and that no provision for depreciation should be written on. It also allowed a French version

11) about 2.7 billion euros.
12) According to the French PCG.
13) For the last 13% of cases, amortization period is unclear.

of the pooling-of-interests for acquisitions paid in stock.

The French Mismatch

In 2004, *IAS 38 Intangible Assets*[14] was revised, resulting in an interesting paradox in Fance. In the new version of international standards, the pooling-of-interests was forbidden and amortization of goodwill was replaced by annual impairment tests.

As the treatment of goodwill corresponded roughly to the traditional stance of the Council of State, French individual accounts conformed-by chance-with the new standard but on the contrary, Regulation 99-02 ruling consolidated accounts became completely obsolete.

The paradox is that, when EU listed companies adopted IFRS in 2005, no reform was passed in order to correct the mismatch between individual accounts, consolidated accounts of listed companies and consolidated accounts of unlisted companies. In short, France is now up to date with IFRS in individual accounts, but obsolete in consolidated accounts of unlisted entities, where goodwill is still amortized, and where the pooling-of-interests is still allowed.

The reason for such paradox can be found in the European origin of the Regulation 99-02 about consolidated accounts. This text is an adaptation of the 7th European directive. In the legal hierarchy, as European law is a higher level than domestic law, it is impossible to adjust the French rules about consolidated accounts without changing the European directive on which they are based.

The European Union has been discussing the opportunity of adopting the international standard for SMEs; yet, the possible scope and timing of such adoption remain unclear. Depending on the next decisions of the EU regarding accounting harmonization, the French mismatch about goodwill may disappear, but it may also continue since the SME standard allows amortization.

To conclude, non-amortization of goodwill in France in the 20th century was globally dominated by budgetary concerns and the stance of the tax administration. It was also supported by companies' lack of own funds and high debt ratios. On the contrary, accounting for goodwill tended to be dominated by Anglo-Saxon practices in consolidated accounts since the 1980s.

4. Accounting for goodwill in Japan

Despite accounting for goodwill has been the subject of much academic literature in Japan before World War two, this contribution has never been reviewed in English-speaking publications. Umehara (2001) introduced two emblematic figures among these authors: Sotaro Takase (1992-1966), a leading figure in finance, and Tetsuzo Ota (1889-1970), a major accounting academic of the 20th century.

Along with this literature, the stance of the tax administration about goodwill was original: unlike in most western countries, amortization was deductible for tax purpose early in the 20th century.

After World War II, the Japanese accounting system was rebuilt by Kiyoshi Kurosawa (1902-1997)

14） Standard issued by the international standards board, implemented in the EU from 2005.

based on the dynamic theory of the American *Asobat*[15] (Sanders et al., 1938). Tax influence on accounting practices shrank in the post-war period to the benefit of the American model of financial disclosure.

4.1. The interwar period

Tax and the development of double entry bookkeeping in Japan

In Japan, double entry bookkeeping was introduced in the second half of the 19th century by European personnel invited by the Meiji government. Despite important pedagogic efforts were made by Yukichi Fukuzawa (1835-1901) in order to generalize western-style bookkeeping in his book *Choai no Ho* (1873), the new method spread only more than 40 years later thanks to the support of legal requirements (Itabashi, 2010).

The first of these requirements was the obligation for corporations to disclose western-style financial statements (Commercial Code, 1899). At the beginning of the 20th century, the number of corporations grew and double entry bookkeeping spread in these entities.

Nevertheless, Itabashi (2010) noted that the production of western-style ledgers remained low until 1917, but increased steadily in the interwar period. The reason for this switch from Japanese to Western bookkeeping comes from the policy of the tax administration. In 1917 and the following years, the tax administration organized public lectures all around the country in order to recommend double entry bookkeeping to taxpayers.

Compared with the double-entry system, traditional Japanese bookkeeping lacked centralization; information was disseminated in many books. Moreover, recording methods were not standardized. Both elements made tax controls based on Japanese books inconvenient, that's why the tax administration strongly supported westernization (Itabashi, 2010).

In Japan, as in France, the development of accounting was governed by state interventionism through taxation. As a matter of fact, the Meiji Restoration (1868-1912) was not only a period of prosperous economic growth, but it was also marked with wars against the neighbouring countries: China (1894), Russia (1905) and Korea (1910). Japanese conquests went on until World War II, increasing dramatically the military budget and subsequent need for taxation. This context contributes to explain why the stance adopted by the tax administration before War World II dominated accounting practices at that time.

Early academic contributions

In the years 1910-1930, many articles were written about accounting for goodwill, and these articles usually refer to German, British, American and even French authors. For that reason, all the main theories of goodwill found in other countries were also represented in Japan.

The dynamic school - capitalization and amortization of goodwill- was represented by Hirano (1920), Sato (1926) and Kurosawa (1930). According to these authors, investment in goodwill is a cost for the

15) *Asobat: A Statement of Basic Accounting Theory.*

business that has to be amortized over the period it benefits[16).

The actuarial school, permanent retention of goodwill, found its advocate with Hirai (1919). This school argues that goodwill is not used out as time passes, and that even if value fluctuates, there is no valid reason to depreciate goodwill systematically[17).

Last but not least, most authors like the jurists Tajiri (1917) and Shida (1917), and the accountants Takase (1920, 1930) and Ota (1921) promoted the static solution-rapid expensing or non capitalization. In this third category, there was a great variety of arguments to support a similar conclusion consisting in "goodwill should not be written on the books". Diversity suggests that these authors do not constitute a homogeneous school of thought.

First, the main argument of the mainstream static view, which was that goodwill had no liquidation value or that the value could not be assessed reliably, is not the main stance of Takase (1920, 1930) and Ota (1921). Moreover, these two authors have produced their own original contribution to the Japanese theory of goodwill.

Takase (1920, 1930)

As far as Takase's work (1920, 1930 and 1950) is concerned, the main contribution consists in goodwill's empirical valuation and financial modelization[18]. His assessment of goodwill is based on market returns and discounted excess earnings in several fields of activity: railway, timber industry, energy and insurance. In this regard, his work should be classified in the field of finance rather than accounting theory.

Despite his major contribution was assessment, his basic stance regarding accounting for goodwill was that it should not be capitalized as an asset (Takase, 1920). In later works also, Takase (1930, 1950) always concluded that even if goodwill had a value, the best way to account for it was to keep it secret.

Ota (1921)

As far as Ota (1921) is concerned, this author recommends like Takase (1920) to write-off goodwill immediately. Yet, Ota (1921) used completely different arguments to reach this conclusion. His main contribution was to analyze the relationships between accounting for goodwill and reserves.

First, Ota (1921) responded to some criticism about the inconsistence of recognizing only acquired goodwill, and not self-generated goodwill. Placing himself in the framework of the dynamic theory[19],
Ota answered that accounting was a matter of cost calculation in a broad sense. As acquisition cost was the expression of goodwill's value, the recognition of acquired goodwill was justified by the existence of this cost.

Then, he refuted the necessity to amortize goodwill, contradicting here the mainstream dynamic school of Hirano (1920), Sato (1926) and Kurosawa (1930). He added that amortizing goodwill was a

16） This is a basic assumption of the dynamic view that could also be found also in German and American literature.

17） This view is commonly adopted in a balance sheet approach, as for example in IAS 38. It is very ancient.

18） As Yang (1927) also did.

19） Later, Ota became a leading figure of the dynamic school, but interestingly, his youth work ended up with a "static" conclusion (according to the categories of Ding et al., 2008).

means of hiding profits from shareholders and reducing dividends in order to constitute hidden reserves.

Next, he also criticized permanent retention. "Permanent retention of goodwill amounts to revaluating equity in order to balance the capital deficit incurred by the merger" (Ota, 1921).

After having refuted the three other solutions, Ota (1921) finally concluded that goodwill should be written off against reserves. This position is close to Dicksee and Tylliard (1906), who recommend writing off goodwill in order to avoid future embarrassment with valuation.

Umehara (2001) places Ota in the dynamic school. It might be true for his late career, but we can remark that his position in 1921 was more conservative than other dynamic authors. The same study considered Takase as a static author, which is really misjudging his contribution about goodwill assessment.

Mainstream static authors at the beginning of the 20th century justified non capitalization of goodwill by a lack of value, a lack of existence, or sometimes the low reliability of goodwill assessment. One of the most influential authors is Hatfield (1913) who criticized the capitalization of goodwill as a device of stock watering: "such an item is not merely immaterial, but also imaginary". On the contrary, Takase (1920, 1930, 1950) relied on the opposite assumption, since he tried to demonstrate the economic value of goodwill by calculating it empirically.

Tax and capital gains

In the 1920s, the Japanese tax administration needed to standardize local accounting practices in order to collect tax efficiently. Evidence described above suggests that this pedagogic action was influential on businesses.

As far as goodwill is concerned, the situation appears much clearer than France at the same period. Yajima, an officer of the Tax office of Tokyo, wrote in 1925[20] that merger goodwill was part of the tax base and should be capitalised on the acquirer's balance sheet. He also mentioned that capital gains arisen from other asset revaluations were taxable according to the same principle. This situation contrasts with France, where capital gain taxation had been censored by the parliament on the same year.

Tax deductibility of amortization

As far as amortization is concerned, the Japanese case is uncommon. In 1933, Hoshino, another officer of the tax administration, wrote that goodwill should be amortized over 10 years. He completed that companies could choose between two amortization methods: straight line, or a method based on excess earnings discounted over a period of 10 years. This second method was derived from Takase's work, which shows how influential he was at that time. Unfortunately, the actuarial amortization method is mentioned in no other study, which suggests that it was not widely implemented in practice.

Although many academics criticized writing on goodwill (Ota, 1921, Nishigaki, 1934), several elements tend to show that the tax method was dominant in the interwar period. For example, the reporting standard of the planning bureau of the Japanese imperialist government included a model of

20) In his first study in 1920, Takase also mentioned the obligation of writing on goodwill for tax purpose, suggesting that this stance was the same from 1917. Unfortunately, we could not find the precise origin of this jurisprudence.

balance sheet in 1930 with some intangibles: patents, concessions, right of using water, goodwill (Kubota, 2001).

4.2. Rise of the dynamic theory and the "pooling-purchase" debate

After the Japanese defeat, the tax system was reformed based on the Shoup Report, and accounting was also transformed on the American model with Kurosawa's collaboration. Just after the war, the tax administration seemed to lose its power in accounting to the benefit of statisticians (Suzuki, 2007a, 2007b) and academics. Yet, the administration still kept an influence in accounting practices in the 1960s.

Rise of the dynamic theory

In 1949 were issued the *Principles of Business Accounting*, a general accounting standard based on the American *Asobat* by Sanders et al. (1938). Kurosawa, its main architect, was a fervent dynamic author since the beginning of his career. Moreover, the moderate conservatism of *Asobat*, a text issued no long after the Great Depression, fitted perfectly in Kurosawa's own views.

Accounting for goodwill in Kurosawa (1951) and Ota[21] (1954) also reflects this moderate conservatism[22] . They recommended capitalizing goodwill and amortizing it over five years, a period much shorter than the tax rule (10 years). Moreover, writing on goodwill in the accounting standard was only allowed and not compulsory, unlike in the original recommendations of the tax administration.

As the new financial accounting rules allowed writing off goodwill immediately or on a shorter period than tax accounting, a conflict between the two standards appeared. This disagreement last until the tax administration finally reduced the amortization period to five years in 1967.

The pooling-of-interests

In 1960, the debates about a new accounting method for business combinations were reported in a roundtable gathering a manager from Hitachi, a tax officer, Kurosawa and Banba, two famous academics (Kurosawa et al., 1960).

On the one hand, Kurosawa and Banba strongly supported the purchase method, based on the argument that goodwill was a cost that contributed to the earning power of the business. On the other hand, practitioners supported non recognition of goodwill using a method they called "tax method[23]", stating that it was already widely used in practice.

In 1980, a survey made by a research group of the Japanese Accounting Association found 49 cases of "pooling-of-interests" out of 95 business combinations. Although it was not defined in the Japanese accounting standards until 2005, the method was very common in Japan (JICPA, 1999).

21） Ota changed his stance about goodwill between 1921 and 1954.

22） Conservatism is probably one of the reasons for which Japanese accounting is often classified in the same group as German accounting, but in fact this may be misleading. Although Japanese accounting institutions have much in common with continental Europe, Kurosawa's post-war reforms seem to be rather based on his own interpretation of interwar American and German authors.

23） This method corresponds to the pooling-of-interests, or *méthode dérogatoire* in France.

In the post-war period, the tax administration was less influent on financial accounting than it used to be under the imperialist regime, to the benefit of Kurosawa's dynamic theory.

4.3. International harmonization and accounting for goodwill in Japan

In the 1990s, several institutional reforms were implemented in order to modernize financial infrastructures in Japan. Financial reporting was of course addressed in these transformations, resulting in two important changes regarding goodwill. As in the French case, both changes were motivated by the globalization of financial reporting, and had nothing to do with tax concerns. These changes tend to confirm that in both countries, financial reporting grew away from the tax rules that were dominant before World War II.

The Accounting Big Bang

During the second half of the 1990s, international harmonization of accounting progressively gained the interest of policy makers. In Europe, the decision to adopt international standards was passed in 2002, but the premises had already started at the end of the 1990s with directives about transparency and fair value.

Japan made no exception to this harmonization policy and in June 1997, a set of reforms was passed in order to modernize the financial disclosure of listed companies (Kawamoto, 2001). As far as goodwill is concerned, the maximum amortization period was lengthened from five years to its economic useful life supposedly inferior to 20 years.

The maximum amortization period for goodwill remained five years in individual accounts and for tax purpose, so that companies had strong incentives to keep their old practices (Garcia, 2010). Moreover, the pooling-of-interests remained very common, since it was not forbidden by the Japanese standards. Consequently, this first reform was rather an invitation to change practices than a real transformation of financial disclosure.

The end of the pooling-of-interests

Only three years after the Big Bang was implemented (1998), SFAS 141 and 142 respectively suppressed the pooling of interests and goodwill amortization. In this circumstance, a new *Standard about Business Combinations* (2003) was passed in Japan; but unexpectedly, the standard confirmed the obligation to amortize goodwill.

To this extend, the new accounting standard reaffirmed the dynamic position that had been dominant in accounting standards after the War, and is also in line with the tax tradition started in the 1920s.

On the other hand, it also reduced the possible scope of application of the pooling-of-interest method: only operations in which the acquirer could not be identified would be accounted for using the pooling-of-interests. As in France, this second step confirmed the progressive separation of financial reporting from tax accounting, possibly because international harmonization was given priority over other issues.

5. Concluding remarks

In this study, we investigated the influence of taxation in goodwill history in Japan and France. In France, the tax administration took the lead in the 1920s and supported permanent retention of goodwill for budgetary reasons resulting from the war. Later, this view was also supported by the low level of own funds in French companies: permanent retention of goodwill improved debt ratios.

In Japan, the tax administration first adopted goodwill amortization over 10 years, but taxed the original capital gains. This treatment was also motivated by budgetary reasons in order to finance war effort in the 1920s.

On the contrary, in the post-war period, financial reporting grew away from tax accounting in both countries. Nonetheless, it is interesting to remark that the Japanese standard-setter still supports the same method that was first generalized by the tax administration in 1917 (amortization of goodwill). Similarly, financial reporting by French companies still perpetuates, even in IFRS, the tradition of goodwill's permanent retention from the 1920s.

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